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Supreme Court of the United States

OCTOBER TERM, 1948.

No.

HANNAH COHEN, Executrix of the Estate of Sol Cohen, Deceased, and DAVID F. COHEN, Intervenor,

Petitioners,

—against—

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Respondent,

—and—

O. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, individually,

Defendants.

PETITION FOR CERTIORARI.

EDWARD J. O'MARA,
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Of Counsel.

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> vant to our problem, namely does it significantly affect the result of a litigation for a federal court to disregard a law of a State that would be controlling in an action upon the same claim by the same parties in a State court?"

Clearly, the posting of a bond in advance to secure the payment of costs, the liability for which may or may not eventuate, "concerns merely the means by which a right to recover, as recognized by the State, is enforced." And the Third Circuit was in error in ruling that the federal courts are bound by the New Jersey statute requiring an advance bond to secure a potential judgment.

Moreover, chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17), like its model, Section 61-b of the New York General Corporation Law, was said to be addressed to certain alleged abuses inherent in derivative stockholders' actions. Assuming *arguendo* that the statute was so directed, for another reason it is clear that it cannot be applied in the federal courts. Congress and this Court have already met the abuses they believe significant by Rule 23[9] of the Federal Rules of Civil Procedure. Thereby, it has been indicated that for the purposes of the Rules of Decisions Act, 28 U. S. C. § 1652 (previously 28 U. S. C. § 725), and *Erie R. R.* v. *Tompkins*, 304 U. S. 64 (1938), federal law, not state law, shall be governing. Rule 23 is an "Act of Congress" within the meaning of the Rules of Decisions Act. See *Sibbach* v. *Wilson & Co.*, 312 U. S. 1, 15-16 (1940). In short, the federal government has occupied the field and in accordance with the very terms of the Rules of Decisions Act state law may not

[9] Rule 23 insures adequate representation, safeguards against lack of good faith by requiring a verified complaint, outlaws the "strike suit" by requiring that the plaintiff be a shareholder at the time of the transaction of which he complains, prevents secret and unfair settlements by forbidding dismissal without the approval of the court and dismissal or compromise without notice to the stockholders.

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govern.[10] Moreover, to use a term drawn from the field of conflict of laws, the federal government has characterized its rule as procedural and therefore conflicting or similar statutes or rules must be similarly characterized for the purposes of the doctrine of *Erie R. R.* v. *Tompkins*.

III.

N. J. R. S. CUM. SUPP. 14:3-15 AND 14:3-17 VIOLATE THE FEDERAL CONSTITUTION.[11]

The constitutional issues presented in this section of the brief and in Section IV can be reached only if the Court rejects the contentions heretofore made that the New Jersey legislation is not applicable in the federal courts. Apart from constitutional objections to the retroactive effect of Chapter 131, the provisions of that chapter, here at issue, violate the federal Constitution in the following manner:

A. Equal Protection of the Laws.

N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 are discriminatory upon their face. They subject to liability for expenses and counsel fees, as well as for security, only stockholders holding shares "having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares" unless the market value of such shares is in excess of $50,000. No basis in law or in fact is available to support this classification. The only classification is upon the basis

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[10] "The laws of the several states, except where the Constitution or treaties of the United States or *Acts of Congress otherwise require or provide*, shall be regarded as rules of decisions in civil actions in the courts of the United States, in cases where they apply." (Emphasis added.)

[11] We do not at this time present argument with respect to the constitutionality of N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 under either the New Jersey Constitution of 1844, which was in effect at the time of the passage of these provisions, or under the New Jersey Constitution of 1947 which subsequently became effective. But we reserve our right to do so, in the event that certiorari is granted.

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Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17) 2, 5, 6, 8, 9, 12, 14, 15, 17, 19, 20

of wealth, and such unequal justice is exactly the type of discrimination outlawed by the Fourteenth Amendment. As the Court stated in *Gulf, C. & S. R. Co. v. Ellis*, 165 U. S. 150, 155 (1897),

> "The State may not say all white men shall be subjected to the payment of the attorney's fees of parties successfully suing them and all black men not. It may not say that all men beyond a certain age shall be alone thus subjected, *or all men possessed of a certain wealth.* These are distinctions which do not furnish any proper basis for the attempted classification." (Emphasis added.)

Assuming that abuses existed in derivative stockholders' actions which this statute was intended to meet, these abuses were not uniquely the characteristics of actions brought by plaintiffs holding a few shares of stock. As one commentator has remarked, "There is * * * no evidentiary support for an assumption that derivative suits brought by those holding $50,000 worth of stock or 5% thereof are more meritorious or brought in better faith than those brought by stockholders owning lesser amounts of shares or that more suits of this character are brought in bad faith by small stockholders than by larger stockholders." Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York Corporation Law* (1945) 54 Yale L. J. 352, 386. Or, in the words of another writer, "a legislative holding that a small shareholder's suit is presumptively a 'strike' suit not only finds no factual basis but constitutes a type of class legislation that is arbitrary, anti-social and Hamiltonian in its economic shortsightedness." Jackson, *Reorganization of the Corporate Concept and the Effect of Section 61-b of the New York General Corporation Law* (1944) 45 Corp. Reorg. & Amer. Bank. Rev. 323, 340.

B. Due Process of Law.

N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 violate both the procedural and substantive aspects of the due process clause of the Fourteenth Amendment. Procedurally, these provisions unreasonably qualify—and in effect deny—access by certain plaintiffs to the courts for legal wrongs. Substantively, the legislation violates the due process clause by imposing arbitrary impediments, without reasonable relation to any existing abuses.

The State of New Jersey has not attempted in terms to exonerate corporate directors and officers from liability for their defalcations involving property of corporations they control. Nor in terms has it forbidden stockholders holding less than five per cent of the outstanding stocks or stocks worth $50,000 or less from bringing suit on behalf of the corporation to remedy such defalcations. But the provisions of New Jersey law, here involved, accomplish these ends as effectively as if such legislation had been passed. No plaintiff, unless he have tremendous resources, can afford to give security in the amount which the statute indicates. Nor certainly will he litigate difficult undecided questions of corporate law when, in the event he loses, he must pay expenses and counsel fees of the corporation and the individual defendants. For apart from the expenses other than counsel fees, "it is not unusual nor would it be unreasonable for defendants in such actions to retain distinguished counsel. Stockholders' actions are ordinarily directed against several defendants, each of them entitled to counsel of his own choice. The anticipated aggregate charge of several prominent law firms for services in a protracted and intricate litigation are bound to be formidable." *Citron v. Mangel Stores Corp.*, 50 N. Y. S. 2d 416, 419 (Sup. Ct. N. Y. Co., 1944). Constitutional rights may be nullified quite as readily and completely by procedural obstructions to their effective assertion and maintenance as by outright substantive denial.

The unreasonableness of the legislation at issue is best demonstrated by the discrepancy between the evils to be

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Defendants.

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitioners respectfully show:

JURISDICTION.

The order of the District Court for the District of New Jersey, denying respondent's motion for security for costs including counsel fees, was entered on November 17, 1947. The judgment of the Court of Appeals for the Third Circuit, reversing the order of the District Court and remanding the cause, was entered on September 22, 1948. Jurisdiction of this Court is invoked under Title 28, §§ 1254(1) and 2101(c).

OPINIONS BELOW.

The opinion of the District Court (R. 29) is reported at 7 F. R. D. 352. The opinion of the Court of Appeals for the Third Circuit (R. 40) is reported at 170 F. 2d 44.

STATUTES AND RULES INVOLVED.

Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17) provides as follows:

> "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action

upon showing that the security provided has or may become inadequate or is excessive.

"This act shall take effect immediately and shall apply to all such actions, suits or proceedings now pending in which no final judgment has been entered, and to all future actions, suits and proceedings."

Rule 23 of the Federal Rules of Civil Procedure provides as follows:

"(a) Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is

(1) joint, or common, or secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it. . . .

"(b) Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because that association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and,

if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

"(c) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. * * *"

STATEMENT.

The controversy at bar arises out of a derivative stockholder's action brought against the individual defendants on behalf of the respondent, Beneficial Industrial Loan Corporation, a Delaware corporation. Jurisdiction of the District Court for the District of New Jersey was based upon diversity of citizenship. The complaint, originally on behalf of Sol Cohen, was filed on August 9, 1943 (R. 1). On August 23, 1943, David F. Cohen was permitted to intervene as party-plaintiff (R. 1). On February 14, 1946, following the death of Sol Cohen, Hannah Cohen, his executrix, was substituted in his stead (R. 5). The petitioners own 250 shares of the common stock of the corporate defendant (R. 13).

It is unnecessary, for the purposes of this petition, to set forth the allegations contained in the original and amended complaints. It suffices to state that serious and sizable defalcations by the officers and directors of Beneficial Industrial Loan Corporation are alleged. Nor is it necessary to detail the various procedural maneuvers which took place between the time of the filing of the original complaint in August, 1943 and the motion for security for costs made by the respondent corporation in August, 1946. The only issues now before the Court arise out of or relate to that motion.

That motion was for an order directing that

> "the plaintiff and the intervener give security to defendant Beneficial Industrial Loan Corporation in the amount of not less than $125,000 for the reasonable expenses, including counsel fees, which may be incurred by said defendant in connection with this action, and for the reasonable expenses, including counsel fees, which may be incurred by the other parties defendant in connection therewith for which defendant Beneficial Industrial Loan Corporation may become subject pursuant to law or to its by-laws[1] or under equitable principles * * *." (R. 10).

The motion was based on Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17), effective April 10, 1945. See pages 2-3, *supra*.

Judge Smith denied the motion and stated in his opinion that the relevant provisions of Chapter 131 were inapplicable to this litigation in a federal court and that, in any event, the law of Delaware, rather than that of New Jersey, would be governing as to the petitioners' liability for the respondent's expenses and counsel fees. The respondent appealed from the decision of Judge Smith to the Court of Appeals for the Third Circuit.

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[1] Article X of the by-laws of Beneficial Industrial Loan Corporation provides in part:

"The Corporation shall indemnify and hold harmless each person who shall serve at any time hereafter as a director or officer of the Corporation from and against any and all claims and liabilities to which such person shall have become subject by reason of his having heretofore or hereafter been a director or officer of the Corporation, or by reason of any action alleged to have been heretofore or hereafter taken or omitted by him as such director or officer, and shall reimburse each such person for all legal and other expenses reasonably incurred by him in connection with any such claim or liability; provided, however, that no such person shall be indemnified against, or be reimbursed for any expense incurred in connection with, any claim or liability arising out of his own negligence or wilful misconduct. The rights accruing to any person under the foregoing provisions of this Article shall not exclude any other right to which he may be lawfully entitled, nor shall anything herein contained restrict the right of the Corporation to indemnify or reimburse such person in any proper case even though not specifically herein provided for. The Corporation, its directors, officers, employees and agents, shall be fully protected in taking any action or making any payment under this Article X or in refusing so to do, in reliance upon the advice of counsel." (R. 12).

The Court of Appeals held that the order of the District Court denying security for costs was appealable. Having determined that it possessed jurisdiction over the appeal, the Court held that the provisions of Chapter 131 here at issue were enforceable in a federal court, that they were constitutional under the federal and New Jersey Constitutions, and that the retroactive application was not violative of either Constitution.

QUESTIONS PRESENTED.

1. Whether the order of the District Court for the District of New Jersey, denying respondent's motion for security for costs and counsel fees, was appealable.

2. Whether a federal court in New Jersey, whose jurisdiction is based upon diversity of citizenship, must apply the laws of New Jersey with respect to security for costs and counsel fees, in a derivative stockholders' action brought by a New York stockholder on behalf of a Delaware corporation.

3. Whether Chapter 131 of the New Jersey Laws of 1945, particularly N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17, if applicable to a federal court whose jurisdiction is based upon diversity of citizenship, violates the federal or New Jersey Constitutions.

4. Whether in its application to actions commenced prior to its enactment Chapter 131 of the New Jersey Laws of 1945, particularly N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17, if applicable in a federal court whose jurisdiction is based upon diversity of citizenship, violates the federal or New Jersey Constitutions.

REASONS FOR GRANTING THE WRIT.

1. A direct conflict exists between the Court of Appeals for the Third Circuit and the Court of Appeals for the Second Circuit, as to whether an order denying security for costs and counsel fees is appealable. In the case at bar, the Court of Appeals for the Third Circuit has held such an order appealable. In *Thompson* v. *Broadfoot & Aspinook Corporation*, decided October 17, 1947 [2] [referred to in *Aspinook Corporation* v. *Bright*, 165 F. 2d 294, 295 (C. C. A. 2d, 1948), and *Thompson* v. *Broadfoot*, 165 F. 2d 744, 745 (C. C. A. 2d, 1948)], the Court of Appeals for the Second Circuit held not appealable an order denying a motion for security made pursuant to Sections 61-b and 64 [3] of the New York General

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[2] This case is unreported. A motion was made to dismiss an appeal from the order of Judge Bright denying security for costs and counsel fees under General Corporation Law, §§ 61-b, 64. The Court (Judges A. Hand, Clark, Frank) entered the following order from which Frank, J., noted his dissent:

"Motion granted on the ground that the appeal from the order must be dismissed because the order is not final."

The Second Circuit has also held that even an order granting security is not appealable. *Donovan* v. *Queensboro Corp.*, No. 156, O. T. 1948, cert. den. October 11, 1948.

[3] § 61-b. Security for expenses.

In any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than five per centum of the outstanding shares of any class of such corporation's stock or voting trust certificates, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to section sixty-four of this chapter, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.

§ 64. Assessment of expenses.

Any person made a party to any action, suit or proceeding by reason of the fact that he, his testator or intestate, is or was a director, officer or employee of a corporation shall be entitled to have his reasonable expenses, including attorneys' fees, actually and necessarily incurred by him in connection with the defense of such action, suit or proceeding, and in connection with any appeal therein, assessed against the corporation or against another corporation at the request of which he served as such director, officer or employee, upon court order, in the manner and to the extent provided by sections

Corporation Law. These provisions, as the Court of Appeals for the Third Circuit stated (R. 47), are, in effect, identical with the provisions of Chapter 131 of the New Jersey Laws of 1945 here at issue. Note (1947) 1 Rutgers U. L. Rev. 117.

2. There are conflicting rulings as to whether statutes such as Chapter 131 are applicable in diversity cases brought in the federal courts.[4] The Third Circuit recognized this conflict in its opinion in this case: "We are aware that our decision is contrary in substance to that of Aspinook Corporation v. Bright, 2 Cir., 165 F. 2d 294, and directly contrary to decisions such as Boyd v. Bell, D. C. S. D., N. Y., 64 F. Supp. 22, and the other authorities cited to the point in 165 F. 2d at p. 295." (R. 53, n. 12). In *Boyd* v. *Bell*, 64 F. Supp. 22 (S. D. N. Y., 1945), it was held that such statutes should not be enforced in a federal court. The same opinion was expressed by Judge Frank in his dissenting opinion in *Aspinook Corporation* v. *Bright*, 165 F. 2d 294, 295 (C. C. A. 2d, 1948). In *Craftsman Finance & Mortgage Co.* v. *Brown*, 64 F. Supp. 168, 178 (S. D. N. Y., 1945), it was held that application of the state statute "in any given case * * * rests in the sound discretion of the Federal Judge * * * " and the motion for security was denied. In *Donovan* v. *Queensboro Corp.*, 75 F. Supp. 131 (E. D. N. Y., 1947), the court apparently applying a rule of discretion, granted security in the sum of $50,000, and in *Gucler* v. *Bossert*, decided August 7, 1948 (S. D. N. Y.), C. C. H., N. Y. Corp. L. Rep. Par. 70,152, the Court exercised its "discretion" to grant security in the amount of $5,000. See also the Note of the Advisory Committee with reference to Rule 23(b) of the Federal Rules of

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sixty-five, sixty-six and sixty-seven of this chapter, and in the instances specified in section sixty-eight of this chapter, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such officer, director or employee is liable for negligence or misconduct in the performance of his duties.

[4] For similar statutes in Maryland, New York, Pennsylvania and Wisconsin, see Hornstein, *New Aspects of Stockholders' Derivative Suits* (1947) 47 Col. L. Rev. 1, 5-6; Koessler, *The Stockholders' Suit: A Comparative View* (1946) 46 Col. L. Rev. 238, 249.

Civil Procedure; Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York* (1944) 32 Calif. L. Rev. 123; Hornstein, *A New Forum for Stockholders* (1945) 45 Col. L. Rev. 35; Hornstein, *New Aspects of Stockholders' Derivative Suits* (1947) 47 Col. L. Rev. 1, 11-12.

3. The constitutionality of Chapter 131 and of similar legislation in other states has been much controverted. Although the New York Court of Appeals has recently held that Section 61-b of the New York General Corporation Law is constitutional on its face, *Lapchak* v. *Baker*, 298 N. Y. 89 (1948), at least one decision of an inferior New York court had held to the contrary. *Citron* v. *Mangel Stores Corp.*, 50 N. Y. S. 2d 416 (Sup. Ct. N. Y. Co., 1944). A District Court Judge has labelled these sections "discriminatory." *Craftsman Finance & Mortgage Co.* v. *Brown*, 64 F. Supp. 165, 178 (S. D. N. Y., 1945). The constitutionality of statutes such as Chapter 131 has also engendered much discussion in the legal periodicals and it has been strongly urged by certain commentators that the legislation is unconstitutional. See Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Law* (1945) 54 Yale L. J. 352; Hornstein, *New Aspects of Stockholders' Derivative Suits* (1947) 47 Col. L. Rev. 1, 4; Note (1947) 1 Rutgers U. L. Rev. 117. See also (1944) 58 Harv. L. Rev. 135.

In view of the dubious constitutionality of the New Jersey statute and in view of its deterrent effect upon meritorious stockholders' actions, this case is one presenting "an important question of federal law which has not been, but should be, settled by this court." Rule 38(5)(b).

4. The retroactive effect of the New Jersey statute presents additional important constitutional questions. Chapter 131 is retroactive by its terms, *i.e.*, it is applicable to suits initiated prior to the enactment of the statute. In this respect it differs from Section 61-b of the New York Corpora-

tion Law, which did not indicate whether it was to be applied to pending cases. The New York courts construed Section 61-b as being prospective only in operation, *Shielcraft* v. *Moffett*, 294 N. Y. 180 (1945), and thereby avoided the constitutional problems which would otherwise have arisen. See the dissenting opinion of Justice Callahan, in *Shielcraft* v. *Moffett*, 268 App. Div. 352 (1st Dept., 1944); Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Law* (1945) 54 Yale L. J. 352, 390. These problems, however, as the Court of Appeals for the Third Circuit recognized, cannot be avoided under the New Jersey statute here at issue. The case at bar was commenced in 1943, and the New Jersey statute was not enacted until 1945.

ARGUMENT.

I.

THE ORDER DENYING RESPONDENT'S MOTION FOR SECURITY WAS NOT APPEALABLE.

The Court of Appeals for the Third Circuit, contrary to the decision by the Court of Appeals for the Second Circuit,[5] has held that an order denying security for costs and counsel fees is appealable.[6]

The principles underlying the "final decision" rule patently read against the appealability of the District Court order denying security for costs. In *Catlin* v. *United States*, 324 U. S. 229 (1945), this Court pointed out that a "'final decision' generally is one which ends the litigation on the merits and leaves nothing for the court to do but execute the

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[5] *Thompson* v. *Broadfoot & Aspinook Corporation*, set forth in note 2 *supra*.

[6] The opinion of the Court of Appeals, filed September 22, 1948, refers to Section 128 of the Judicial Code, 28 U. S. C. § 225. The new Title 28, effective September 1, 1948, does not modify the "final decision" rule. 28 U. S. C. § 1291.

judgment." *Id.* at 233. "The foundation of this policy is not in merely technical conceptions of 'finality.' It is one against piecemeal litigation. 'The case is not to be sent up in fragments' * * *. *Luxton* v. *North River Bridge Co.*, 147 U. S. 337. Reasons other than conservation of judicial energy sustain the limitation. One is elimination of delays caused by interlocutory appeals." *Id.* at 233-34. The Court went on to state that a decision is not reviewable "whenever the question may be saved for disposition upon review of final judgment disposing of all issues involved in the litigation or in some other adequate manner." *Id.* at 236.

The District Court order did not "end the litigation on the merits." The Court of Appeals by accepting the appeal permitted the case to come "up in fragments." And certainly the question, in so far as matters other than security are affected, "may be saved for disposition upon review of final judgment disposing of all issues involved in the litigation." In so far as security is concerned, respondent is in the same position respecting appealability as a defendant who unsuccessfully moves for security for costs against a non-resident plaintiff in a non-derivative action. These are the guiding rules that caused the Second Circuit to refuse to accept an appeal from a similar order. The reasons for rejecting these principles, offered by the Third Circuit, are clearly fallacious.

That Court purported to rely primarily upon two decisions of the Supreme Court. The first, *Trustees* v. *Greenough*, 105 U. S. 527 (1882), held that "under all the circumstances" the order of the Circuit Court granting costs, expenses and allowances "out of a trust fund under the control" of the court was appealable. On its face the case is inapplicable to the situation at bar. In the first place, the order in the case now before the Court relates not to the grant or denial of costs but to security for them. If the New Jersey statute is applicable and constitutional, respondent, regardless of any decision at this time, may be entitled to expenses and counsel fees upon the termination of the action. In the second place,

the order at bar denies security. And just as denial of a summary judgment is not appealable,[7] though the grant of summary judgment is a final decision, so here, even if we assume that an order granting security would be appealable, an order denying such security is not, since it resolves no controversy, stops no proceedings, and may be reviewed later upon an appeal from a final decision.[8]

Nor does the second case relied upon by the Court of Appeals, *Sprague* v. *Ticonic Bank*, 307 U. S. 161 (1939), support its decision. That case held a denial of a petition for counsel fees and expenses an appealable order, because the matter had never previously been in issue and because the denial or grant of such fees and expenses could not thereafter be reviewed upon a subsequent appeal, all other proceedings having been completed.

But it is not necessary to look solely to the inadequacy of the precedents cited by the Court. The New Jersey statute provides for the granting or amending of an order for security for costs at any time during the proceedings. If an order denying security is appealable, so too, on the reasoning of the Third Circuit, would be orders amending the amounts of security required. The consequences would be numerous interlocutory appeals delaying and hindering the action in contravention of the "final judgment" rule.

II.

N. J. R. S. CUM. SUPP. 14:3-15, 14:3-17, ARE NOT APPLICABLE IN A FEDERAL COURT.

It is important to note, at this time, the two distinct questions underlying the issues of this case. The first is whether a federal court, in a diversity case, must follow the procedure of requiring security to be posted in advance to which the corporation might be able to look for costs and attorneys

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[7] *Jones* v. *St. Paul Fire & Marine Ins. Co.*, 108 F. 2d 123 (C. C. A. 5, 1939); *Belmar Hats* v. *Young America Hats*, 116 F. 2d 956 (C. C. A. 2, 1941); *Drittel* v. *Friedman*, 154 F. 2d 653 (C. C. A. 2, 1946).

[8] *Catlin* v. *United States*, 324 U. S. 229, 236 (1945).

fees in the event that the individual defendants prevail in the action. The second is whether the federal court must award a corporation costs and expenses upon the failure of the plaintiffs to prove their cause of action. The questions are distinct for the reason that even if a plaintiff might ultimately be liable for fees and expenses by reason of the New Jersey statute, the New Jersey procedure of providing security from which those fees and expenses would be paid would not have to be adopted. On the other hand, it would be futile to rule that the security must be posted in advance unless the corporation might be entitled to reimbursement for the fees and expenses provided for in the New Jersey statute. Thus, only if the Court should rule that the first question must be answered in the affirmative need it look to the second. If the Court rules, as it should, that the posting of security in advance is a procedural matter not binding on a federal court the second question need not concern it at this time. Discussion of the second question and the necessary historical inquiry as to whether expenses and legal fees are "substantive" or "procedural" will, therefore, be postponed to the brief on the merits.

Whether a bond is to be posted in advance is clearly a question of procedure which, even in diversity cases is not controlled by state rules. Admittedly the dichotomy between procedure and substance is based on a wavering line. But for the purposes of *Erie R. R.* v. *Tompkins*, 304 U. S. 64 (1938), and the Rules of Decisions Act, 28 U. S. C. § 1652, this Court has set down the distinguishing line. Thus, in *Guaranty Trust Co.* v. *York*, 326 U. S. 99, 109 (1945), the distinction was stated in this way:

> "And so the question is not whether a statute of limitations is deemed a matter of 'procedure' in some sense. The question is whether such a statute concerns merely the manner and the means by which a right to recover, as recognized by the State, is enforced, or whether such a statutory limitation is a matter of substance in the aspect that alone is rele-

cured and the "remedies" adopted by the statute. The principal wrongs that may arise in stockholders' suits are (1) the bringing of a suit without any reasonable basis in order to secure a payment to prevent harassment; (2) the private settlement of suits either to avoid such harassment or to buy off the revelation of the wrongdoing that the action would bring into the open; (3) the large costs that a corporate defendant must incur to defend groundless suits.

The statute, however, makes no distinction between groundless suits and suits based on reasonable grounds; it does not prevent the secret settlements by means of which meritorious suits are prevented from being carried to a successful conclusion or non-meritorious suits are simply bought off by the defendants; it does not provide for the reimbursements of large costs incurred in the defense of a groundless suit unless the plaintiff owns less than a specified amount of stock—a distinction already shown to be arbitrary.

The distinction between the alleged bases for the statute and the unstated real premises is further ascertained by the difference between the legislation as enacted and the remedies available to the legislature if its purpose were what it pretends to be. The New Jersey legislature could have subjected all plaintiffs in stockholders' actions to liability for expenses upon a judicial finding of lack of good faith, *cf.* e.g., Section 11(e) of the Securities Act of 1933 as amended, 11 U. S. C. § 77(k)(e).; it could have outlawed secret settlements either by requiring notice to all shareholders or by insisting upon judicial approval. These remedies it could have chosen, in addition to more radical improvements such as granting to an administrative agency powers of scrutiny over corporate transactions and of enforcement of private rights. That it legislated as it did, despite the multiple choices open to it, indicates that the statute was intended, not as a correction of abuses but as a "death knell" of the small stockholders' only remedy for corporate wrongs, an objective which it could not openly seek or achieve without running afoul of the Fourteenth Amendment's due process clause.

C. Full Faith and Credit.

In so far as N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 apply to actions by residents of other states on behalf of foreign corporations, they violate the full faith and credit clause of the federal Constitution and are an attempt by the State of New Jersey to affect relationships in which it has no interest and over which it has no control. They create the very barriers which "it has been the whole course of our law to break down * * * against calling corporations to account in all states where they may do wrong in doing business." Mr. Justice Reed dissenting in *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518, 538 (1947).

Although *United Commercial Travelers* v. *Wolfe*, 331 U. S. 586 (1946), was limited to a denial of the power of South Dakota to impose its statute of limitations with respect to a fraternal benefit society organized in Ohio, the policy behind that decision restricting the law of the forum is applicable to the New Jersey statute. The relationship between the corporation, the stockholders, and the officers and directors is created by Delaware law. It is from the right of incorporation which Delaware statutory law confers that the rights and liabilities of the respective parties spring. Even if they arise from decisional rather than enacted law it does not matter; for "what is entitled in proper cases to full faith and credit is the law of a state by whatever source declared." Jackson, *Full Faith and Credit—The Lawyers' Clause of the Constitution* (1945) 45 Col. L. Rev. 1, 12. The analogy to *Broderick* v. *Rosner*, 294 U. S. 629 (1935), is a very close one. In that case, New Jersey attempted by statute to bar an action, brought by the Superintendent of Banks of New York, against New Jersey residents, who were stockholders in the Bank of the United States, to recover assessments levied by him in accordance with the law of New York, where the banking corporation had been organized. Mr. Justice Brandeis for the Court held that the New Jersey law could not govern. As he stated, "Obviously recognition could not be accorded to a local policy of New Jersey, if these really

were one; of enabling all residents of the State to escape from the performance of a voluntarily assumed statutory obligation, consistent with morality * * *.'" 294 U. S. at 644.

IV.

THE RETROACTIVE APPLICATION OF N. J. R. S. CUM. SUPP. 14:3-15, IN ACCORDANCE WITH THE TERMS OF N. J. R. S. CUM. SUPP. 14:3-17, VIOLATES THE FEDERAL CONSTITUTION.[12]

The retroactive application of the provisions of Chapter 131, here at issue, since they would effectively destroy the sole remedy of the stockholder to prevent the defalcations of officers and directors, violates the federal Constitution in the following respects:

A. Due Process of Law.

When a corporation has refused a proper demand to remedy wrongs done it or when such a demand would be futile, equity confers upon the stockholders a cause of action in the corporation's right. *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518 (1947). This cause of action is a property right, *Citron* v. *Mangel Stores Corp.*, 50 N. Y. S. 2d 416 (Sup. Ct. N. Y. Co., 1944), as are other vested rights of action. *Pritchard* v. *Norton*, 106 U. S. 124, 132 (1882). To the extent it is not prosecuted, the shareholder's proportionate interest in the corporation is diminished.

At the time of the enactment of Chapter 131 this property right had fully ripened. The wrongs had been committed;

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[12] We do not at this time present argument with respect to the constitutionality of the retroactivity of N. J. R. S. Cum. Supp. 14:3-15 in accordance with the terms of N. J. R. S. Cum. Supp. 14:3-17, under either the New Jersey Constitution of 1844, which was in effect at the time of the passage of these provisions or under the New Jersey Constitution of 1947 which subsequently became effective. But we reserve our right to do so, in the event that certiorari is granted.

the corporation's assets had been diminished by the misdeeds of the defendants; suit had been instituted.

> "* * * A statute, under the form of taking away or changing a particular remedy, may take away an existing property right, or impair the obligation of contract." *Ettor v. Tacoma*, 228 U. S. 148, 155 (1913).

Whatever may be the power of the state to modify or repeal remedies and whatever its power may be to abolish old rights "recognized by the common law, to obtain a permissible legislative object," *Silver v. Silver*, 280 U. S. 117, 122 (1929), the state may not destroy all remedies to enforce a pre-existing cause of action. *Ettor v. Tacoma, supra.* What Mr. Justice Holmes stated in *Forbes Pioneer Boat Line v. Board of Commissioners*, 258 U. S. 338, at 339, 340 (1922), is wholly applicable to this case.

> "Stripped of conciliatory phrases the question is whether a state legislature can take away from a private party a right to recover money that is due when the act is passed."
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> * * * * *
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> "Defendant owed the plaintiff a definite sum of money that it had extorted from the plaintiff without right. It is hard to find any ground for saying that the promise of the law that the public force shall be at the plaintiff's disposal is less absolute than it is when the claim is for goods sold."

B. Impairment of Contract.

Under the law evidenced by such cases as *Coombes* v. *Getz*, 285 U. S. 434 (1932), and *Hathorn* v *Calef*, 2 Wall. 10 (1865), the retroactive effect of the New Jersey provisions of law here at issue impairs the obligation of contract. The petitioners' relationship with the respondent corporation was, of course, contractual. Part of that contract was the right given them by Delaware law to bring a derivative action for wrongs to the corporation; for "the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms." *Van Hoffman* v. *Quincy*, 4 Wall. 535, 550 (1867), quoted in *Wood* v. *Lovett*, 313 U. S. 363, 370 (1941). See *Coombes* v. *Getz, supra.* The law so incorporated may be non-statutory, *Bronson* v. *Kenzie*, 1 How. 311, 319 (1843), as well as statutory.

New Jersey, by attempting to deprive petitioners of the benefit of the law under which they contracted, has impaired that contract.

CONCLUSION.

For the reasons heretofore set forth, petitioners respectfully submit that this Court issue a writ of certiorari to the Court of Appeals for the Third Circuit to review this case.

Respectfully submitted,

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